

COLVILLE RIVER UNIT AGREEMENT

APPLICATION FOR THE SECOND EXPANSION OF THE UNIT AREA

FINDINGS AND DECISION OF THE DIRECTOR,
DIVISION OF OIL AND GAS UNDER DELEGATION OF AUTHORITY
FROM THE COMMISSIONER,
DEPARTMENT OF NATURAL RESOURCES
STATE OF ALASKA

November 08, 2002
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I. INTRODUCTION, BACKGROUND, AND CONCLUSION

On August 1, 2002, ConocoPhillips Alaska, Inc. (“ConocoPhillips”), as Operator and on behalf of the other working interest owners (WIOs), applied for approval of the Second Expansion of the Colville River Unit (CRU) (Application) under the provisions of 11 AAC 83.356 and Section 12.1 of the CRU Agreement. The CRU is the first unit formed in Alaska with a private party -- Arctic Slope Regional Corporation (ASRC)—as the lessor of a significant portion of the unit area. With this Application, ConocoPhillips proposes to add 40 leases and approximately 59,865 acres to the current unit area. The leases are described in Attachment 1 of this document and shown on the map provided by ConocoPhillips as Attachment 2 of this document. The proposed expansion leases are grouped into four areas as listed below.

<u>Area</u>	<u>Acreage</u>
Oberon	26,624.00
Titania	16,258.57
Nanuq	10,210.06
Fiord	6,772.11

DNR determined that the Application was complete on August 30, 2002. Notice of the Application was published in the Anchorage Daily News and The Arctic Sounder on September 5, 2002. Copies of the Application and the public notice were also provided to interested parties under 11 AAC 83.311. DNR also provided public notice to the Alaska Departments of Environmental Conservation and Fish and Game, the North Slope Borough, the City of Nuiqsut, the City of Barrow, the Kuukpik Village Corporation, ASRC, Nuiqsut Postmaster, the radio station, KBRW in Barrow, and the Alaska Oil and Gas Conservation Commission.

The public notices invited interested parties and members of the public to submit comments by October 7, 2002. DNR received three comments. First, Alfred James, an overriding royalty owner in ADL 388527, expressed an opinion that ADL 388527 should be included into the CRU. Second, John Jay Darrah, Jr., expressed an opinion regarding the western portion of the same lease-- ADL 388527. Third, a representative of some Native Allotment owners in the vicinity of the proposed expansion expressed concern that approval of the CRU expansion would limit or diminish access to their allotments. The first and second comments are addressed in Section II.A.2. of this document, and the third comment is addressed in Section II. A.1.

The Agreement requires the Unit Operator to file plans of exploration, development and operations describing the activities within the unit area and expansion area. The Unit Operator must consider how it can best develop the resource underlying the entire unit area, regardless of internal lease boundaries. The revised initial unit plan includes a plan of exploration (POE) and a plan of development (POD). The revised initial POE describes plans to explore for potential prospects other than the currently producing Alpine Reservoir. The plan of exploration submitted with the Application outlines further delineation and development of the Fiord and Nanuq Prospects, as well as exploration plans for the Titania and the Oberon Prospects within the expanded CRU boundary.

The Agreement provides for separate approval of the unit plan of operations by the DNR Commissioner before any operations begin within the unit area on lands managed by the State. The unit plan of operations must contain: (1) Statements and maps or drawings giving the sequence and schedule of operations; (2) the projected use requirements of the proposed operations; including the location and design of well sites, material sites, water supplies, waste sites, buildings, roads and utilities; (3) plans for rehabilitating the affected area; and (4) a description of procedures designed to minimize adverse effects on other natural resources and other uses of the area, including fish and wildlife habitat, historic and archeological sites, and public use. These plans are to be circulated to other State and local agencies for their review and comment before approval by the DNR Commissioner. The proposed plans must also be consistent with the Alaska Coastal Management Program.

ConocoPhillips proposes to expand the CRU to include all or some portions of 40 oil and gas leases encompassing an area of approximately 59,865 acres of lands and tide and submerged lands within the Colville River Delta. Inclusion of the leases in the CRU will conform and modify the leases to the provisions of the CRU Agreement. Attachment 1 describes the working and royalty interests in the 40 leases proposed for the Second CRU expansion. Attachment 2 is a map showing the leases and their assigned unit tract numbers (CRU Tracts 95 through 185). Following is a summary of the history of the 40 expansion leases within the four expansion areas--Oberon, Titania, Nanuq and Fiord.

The proposed Oberon Expansion Area includes 12 leases and approximately 26,624 acres. Four leases were acquired in State Lease Sale No.13, Prudhoe West, held on December 9, 1964. These leases, ADLs 25580 (CRU Tract 172), 25595 (CRU Tracts 173-174), 25598 (CRU Tract 179), and 25613 (CRU Tract 180), were issued on lease form, DL-1 (Rev. Oct.1963), which reserves a 12.5 percent royalty share for the State. These leases were issued effective February 1, 1965, for a primary term of 10 years, as conditional leases. The leases were issued as conditional because the U.S. Department of Interior, Bureau of Land Management (BLM) had not yet issued a land patent to the State.

Five other leases were also acquired in State Lease Sale No.13, Prudhoe West, held on December 9, 1964. These leases, ADLs 25577 (CRU Tracts 162-163), 25578 (CRU Tracts 164-167), 25579 (CRU Tracts 168-171), 25596 (CRU Tracts 175-176), and 25597 (CRU Tracts 177-178), were also issued on lease form, DL-1 (Rev. Oct.1963). The leases were issued effective February 1, 1965, for a primary term of 10 years, as conditional leases. The State jointly owns these leases with ASRC under the terms of a 1991 settlement agreement between ASRC and the State regarding a dispute over ownership of lands located near Nuiqsut and Point Lay.

On December 6, 1991, BP Exploration (Alaska) Inc. appealed the Division Director's decision ending the conditional status of leases in the Colville River Delta, including five of the above leases. In November 1992, the lessors and lessees settled their dispute over the removal of the conditional status of the leases. The State/ASRC/ARCO/BP Settlement Agreement provided in part that the leases would expire on November 11, 2002.

ADL 390053 (CRU Tract 181) was sold in State lease sale North Slope Areawide 2001 held on October 24, 2001. The lease form, DOG 200004, reserves a 16.667 percent royalty share for the State. The lease became effective September 1, 2002 for a primary term of 7 years.

ADL 384212 (CRU Tract 185) was sold in State Lease Sale No. 75A, Colville River Exempt: Colville River Delta Onshore, held on September 21, 1993. The lease form, DOG 9208AS (Rev. 5/93), reserves a 16.667 percent royalty share for the State and ASRC. The lease became effective November 1, 1993 for a primary term of 10 years.

ADL 380080 (CRU Tracts 182-184) was sold in State Lease Sale No. 75, held on December 8, 1992. The lease is jointly held with ASRC. The lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC. The lease became effective on February 1, 1993 for a primary term of ten years.

The Titania Expansion Area includes 16 leases and approximately 16,259 acres. ADL 380042 (CRU Tract 128), ADL 380043 (CRU Tracts 137-138), ADL 380044 (CRU Tracts 135-136), ADL 380045, ADL 380046, and ADL 380048 were issued in State Lease Sale No. 75, held on December 8, 1992. These leases are jointly held with ASRC. The lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC. The leases became effective on February 1, 1993 for a primary term of ten years.

ADLs 384202, 384203, 384204, 384205, and 384206 were sold in State Lease Sale No. 75A, Colville River Exempt: Colville River Delta Onshore, held on September 21, 1993. These leases are held jointly with ASRC. They were issued on lease form DOG 9208AS (Rev 5/93), reserving a 16.667 percent royalty share for the State and ASRC. The leases became effective November 1, 1993 for a primary term of ten years.

ADL 388902 (CRU Tract 134) was created when ADL 380077 was severed and committed in part to the CRU on March 20, 1998. ADL 380077 was sold in State Lease Sale No. 75, and is jointly held with ASRC. The lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC. The lease became effective on February 1, 1993 for a primary term of ten years.

ADLs 389113, 389114, 389115, and 389116 were sold in State Lease Sale No. 87, North Slope Areawide, held on June 24, 1998. These leases are held jointly with ASRC. They were issued on lease form DOG 9208AS (Rev 6/97), reserving a 12.5 percent royalty share for the State and ASRC. The leases became effective November 1, 1998, for a primary term of seven years.

The Nanuq Expansion Area includes seven leases and approximately 10,210 acres. ADLs 380043 (CRU Tracts 129-130), 380044 (CRU Tract 131), and 380081 (CRU Tracts 118-119 and 125-126) were sold in State Lease Sale No. 75, and are jointly held with ASRC. The lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC. The leases became effective on February 1, 1993 for a primary term of ten years.

ADLs 388902 (CRU Tracts 122-123, 132-133) and 388903 (CRU Tract 124) were created when ADL 380077 and ADL 380082, respectively, were severed and committed in part to the CRU on

March 20, 1998. Both ADL 380077 and AD 380082 were originally sold in State Lease Sale No. 75, and are jointly held with ASRC. The lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC. The leases became effective on February 1, 1993 for a primary term of ten years.

ADL 388905 (CRU Tract 121) was created when ADL 387209 was severed and committed in part to the CRU on March 20, 1998. ADL 387209 was sold in State Lease Sale No. 86A, Colville River Exempt: Colville River State Onshore, State/ASRC Onshore and Offshore, held on October 1, 1996. The lease is held jointly with ASRC. ADL 387209 was issued on lease form DOG 9607(SSR)AS which reserves a sliding scale royalty share between 16.66667 and 33.33333 percent for the State and ASRC. The lease became effective October 1, 1996 for a primary term of seven years.

ASRC is the sole lessor of the seventh lease proposed for inclusion into the Nanuq Expansion Area. ARCO, now ConocoPhillips, and ASRC signed the Western Colville/NPR-A Agreement on September 1, 1995, granting ConocoPhillips this ASRC lease. The lease, ALK-4743 (CRU Tract 120), was effective September 1, 1995, and grants exclusive right to explore for oil, gas, and associated hydrocarbon substances for a primary term of ten years. The lease reserves a 15 percent net royalty share for ASRC, with an overriding royalty share of 1.6667 percent to the Kuukpik Village Corporation. The lease is subject to section 1431(o) of the Alaska National Interest Lands Conservation Act (ANILCA) and the 1987 Agreement between ASRC and the Kuukpik Corporation.

The Fiord Expansion Area includes eight leases and approximately 6,772 acres. ADL 380093 (CRU Tracts 100-104, and 106) was sold in State Lease Sale No. 75, held on December 8, 1992. This lease is jointly held with ASRC, and the lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC. The lease became effective on February 1, 1993 for a primary term of ten years.

ADL 388904 (CRU Tracts 95, 98 and 99) was created when ADL 380095 was severed and committed in part to the CRU on March 20, 1998. ADL 380095 was originally sold in State Lease Sale No. 75, and is jointly held with ASRC. The lease form, DOG 9208AS, reserves a 16.667 percent royalty share for the State and ASRC.

ADLs 388527 (CRU Tracts 112-113 and 115-116), 388528 (CRU Tract 109) and 388529 (CRU Tract 108) were sold in State Lease Sale 86, Central Beaufort Sea: Harrison Bay to Flaxman Island held on November 18, 1997. The lease form, DOG 9208AS (Rev. 6/97), reserves a 16.66667 percent royalty share for the State and ASRC. The lease became effective January 1, 1998 with a primary term of seven years.

ADL 389726 (CRU Tract 105) was created when ADL 388525 was severed and committed, in part, to the CRU with the first expansion of the CRU on November 9, 2000. ADL 388525 was sold in State Lease Sale 86, and the lease form, DOG 9208AS (Rev. 6/97), reserves a 16.66667 percent royalty share for the State and ASRC. The lease became effective January 1, 1998 with a primary term of seven years

ADL 389725 (CRU Tracts 107, 110, 111, 114, and 117) was created when ADL 387215 was severed and committed, in part, to the CRU with the first expansion of the CRU on November 9, 2000. ADL 384215 was issued in State Lease Sale No. 75A, Colville River Exempt: Colville River Delta Onshore held on September 21, 1993, and is held jointly with ASRC. The lease was issued on lease form DOG 9208AS (Rev 5/93), reserving a 16.667 percent royalty share for the State and ASRC. The lease became effective November 1, 1993 for a primary term of ten years.

ADL 388906 (CRU Tracts 96-97) was created when ADL 387211 was severed and committed, in part, to the CRU with the first expansion of the CRU on November 9, 2000. ADL 387211 was issued in State Lease Sale No. 86A, Colville River Exempt: Colville River State Onshore, State/ASRC Onshore and Offshore, held on October 1, 1996, and is held jointly with ASRC. ADL 387211 was issued on lease form DOG 9208 AS (Rev 5/96), which reserves a 16.66667 percent royalty share for the State and ASRC, and became effective October 1, 1996 for a primary term of seven years.

All of the leases proposed for inclusion into the CRU as a result of Lease Sales 75, 75A, and 86A are owned jointly by the State and ASRC. The joint ownership was established by the 1991 State-ASRC Settlement Agreement, approved by the legislature in Chapter 41 SLA 1992. The ownership split between the State and ASRC varies from lease to lease, as described in the Settlement Agreement. The State and ASRC administer their individual interests independently. Currently, working interest ownership is aligned for the proposed expansion leases (ConocoPhillips Alaska Inc. 56%, Phillips Alpine Alaska, Inc. 22%, and Anadarko Petroleum Corporation 22%) except ADLs 389725, 384202, 384204 and 384212, where W. H. Hunt has a 0.38% working interest.

The Kuukpik Village Corporation owns the surface estate of the leases in Lease Sales 75, 75A, within NPR-A, in Lease Sale 86A, and the ASRC-only lease.

For reasons set out in this decision, the Division approves the expansion of the CRU, subject to the work program, bid deferment payments, changes in lease agreement terms, and automatic contraction provisions contained in this decision.

II. DISCUSSION OF DECISION CRITERIA

The Commissioner of the Department of Natural Resources (the Commissioner) reviews applications to expand unit areas under AS 38.05.180(p) and 11 AAC 83.303 – 11 AAC 83.395. By memorandum dated September 30, 1999, the Commissioner approved a revision of Department Order 003 and delegated this authority to the Director of the Division of Oil and Gas. The Division's review of the Application is based on the criteria set out in 11 AAC 83.303 (a) and (b). A discussion of the subsection (b) criteria, as they apply to the Application, is set out directly below, followed by a discussion of the subsection (a) criteria.

A. Decision Criteria considered under 11 AAC 83.303(b)

1. The Environmental Costs and Benefits of Unitized Exploration or Development

The lands in and surrounding the CRU are habitat for a variety of fish, waterfowl and marine mammals. Area residents occasionally use these lands and waters for subsistence hunting and fishing. Oil and gas activity in the proposed unit expansion area will impact some wildlife habitat, and may impact some subsistence activity. The extent of these impacts depends on a number of variables. DNR can control some of the variables to minimize the impacts. The environmental impact will depend on the effectiveness of mitigation measures, the availability of alternative habitat and subsistence areas, and the ability of the fish, waterfowl and marine mammals to adapt to some displacement and changes in their habitat.

DNR develops lease stipulations through the lease sale process to mitigate the potential environmental impacts from oil and gas activity. Alaska statutes require DNR to give public notice and issue a written finding before disposal of the State's oil and gas resources. AS 38.05.035(e), AS 38.05.945, 11 AAC 82.415. In preparing a written finding before an oil and gas lease sale, the commissioner may impose additional conditions or limitations beyond those imposed by law. AS 38.05.035(e).

DNR considered all comments filed before holding Lease Sales 75, 75A, 86, 86A, and 87. DNR included mitigation measures in the leases issued. The proposed CRU expansion leases contain stipulations designed to protect the environment and address any outstanding concerns regarding impacts to the area's fish and wildlife species and to habitat and subsistence activities. They address such issues as the protection of primary waterfowl areas, site restoration, construction of pipelines, seasonal restrictions on operations, public access to, or use of, the leased lands, and avoidance of seismic hazards. Including the leases in the CRU will not result in additional restrictions or limitations on public access to the lands or to public and navigable waters. All lease operations before or after unitization are subject to a coastal zone consistency determination, and must comply with the terms of both the State and North Slope Borough coastal zone management plans. Lease and unit operations also require approval of a State plan of operations.

Ongoing mitigation measures such as seasonal restrictions on specific activities in certain areas will reduce the impact on bird, fish, and mammal populations. Designating primary waterfowl areas is one method of protecting the bird habitat. DNR requires consolidation of facilities to minimize surface disturbances. Regulating waste disposal is another way to limit environmental impacts. With these mitigating measures, the anticipated exploration and development related activity is not likely to significantly impact bird, fish, and mammal populations. The anticipated activity under the expanded CRU will impact habitat and subsistence activity less than if the lessees developed the leases individually. Unitized exploration, development and production will minimize surface impact.

Nancy S. Wainwright, on behalf of Joseph K. Akpik, Lydia Sovalik, Joeb Woods and Abraham Woods, submitted comments on the CRU expansion during the public comment period. Ms. Wainwright's comments address the concerns of Native Allotment owners in the vicinity of the CRU expansion, in particular, that the proposed unit expansion would limit or diminish access to their Native Allotments. The Native Allotments in question are not located within the proposed

CRU expansion area. They are located adjacent to, immediately to the east of, the proposed expansion acreage ADL 388904, which is within the Fiord Expansion Area.

Native Allotment, U. S. Survey 9502, Lot 1, BLM Patent # 50-99-0358, belongs to Nannie Woods, while Native Allotment, U. S. Survey 9502, Lot 2, BLM Patent # 50-92-0284, belongs to Lydia Sovalik. The mineral estate under these two allotments is owned by the federal government, and was leased as Tract 2002-H-157 to ConocoPhillips, et al. by the BLM at the NPR-A Lease Sale 2002 held on June 3, 2002. This tract is not proposed for inclusion into the CRU.

There are two Native Allotments in ADL 388901, which was included into the CRU on November 9, 2000. The two allotments in ADL 388901 are U.S. Survey 6671, Lot 1, NA# 11949, BLM Patent # 50-91-0534, which belongs to Joeb O. Woods, and U.S. Survey 6671, Lots 2 and 3, NA # 11951, BLM Patent # 50-92-0017, which belong to Abraham Woods. Joeb Woods and Abraham Woods individually did not comment to the proposed Second CRU expansion. Based on Division records, Mr. Akpik does not have a Native Allotment adjacent to or within the proposed Fiord Expansion Area. The Division's response will address the relevant issues raised by Ms. Wainwright representing the Native Allotment owners.

The proposed CRU expansion leases contain stipulations designed to protect the environment and address any outstanding concerns regarding impacts to the area's fish and wildlife species and to habitat and subsistence activities. The expansion leases address the issue of public access to, or use of, the leased lands. Additionally, when the State approves a plan of operations, it has the right to impose additional or different mitigation measures, including those used in the most recent lease sale. The mitigation measures for the most recent lease sale leases in the unit, in this case Sale 86 and Sale 87, provide the following: (1) no restriction of public access to, or use of, the leased area will be permitted as a consequence of oil and gas activities except in the immediate vicinity of drill sites, buildings, and other related facilities; (2) no lease facilities or operations may be located where they would block public access to or along navigable and public waters as defined in AS 38.05.965(12) and (16). If lease facilities will be located in the vicinity of these public waters, an easement will be reserved under AS 38.05.127 and 11 AAC 53.330 to ensure the right of public access; and (3) The Director, DO&G, will restrict lease-related surface use when the Director determines it is necessary to prevent unreasonable conflicts with local subsistence harvests. Attachment 4 to this Findings and Decision has the specific mitigation measures that address the concerns of the allotment owners. Including the leases in the CRU will not change these stipulations. The stipulations are in effect whether the leases are unitized or not.

To address the concerns on Native Allotments and subsistence uses by local residents of Nuiqsut, and before holding Lease Sale 86, the Division held a public hearing in Nuiqsut on February 26, 1997 to take comments regarding the preliminary finding for the then upcoming proposed Lease Sale 86. The Best Interest Finding of the Director, proposed Oil and Gas Lease Sale 86, dated August 20, 1997, Volume II: Appendices, Section B, includes a summary of the comments of the Nuiqsut participants at the public hearing and DNR responses to the comments. The Nuiqsut participants included Joseph Akpik, Leonard Lampe Sr. (currently a member of the Board of Directors of the Kuukpik Village Corporation and President of the Native Village of Nuiqsut), Ruth Nukapigak, Sarah Kunakna, Thomas Napageak, and Isaac Nukapigak (also a member of the Kuukpik Village Corporation Board of Directors). As noted in Attachment 4, the

concerns of these participants are addressed in the mitigating measures and lessee advisories incorporated in Sale 86 and Sale 87.

The surface estate of the uplands within the Colville River Delta portion of Sales 75, 75A, 86, 86A, and 87 falls into one of two ownership categories: the land owned by the Kuukpik Village Corporation, and the land owned by Native Allotees. For the Kuukpik-owned surface outside of the National Petroleum Reserve, Alaska (NPR-A), a 1974 Agreement between Kuukpik, ASRC, and the State of Alaska, and a 1992 Settlement Agreement between ASRC and Kuukpik provided for the right of access to Kuukpik's surface. ASRC and the State of Alaska, their successors, assignees, and lessees were allowed to conduct oil and gas activities on Kuukpik's lands east of NPR-A under the provisions of the 1992 Settlement Agreement, the leases, and, to the extent applicable, the requirements of AS 38.05.130.

For the Kuukpik-owned surface inside NPR-A, the lessee of any State of Alaska-ASRC jointly held lease may not exercise its access rights to the Kuukpik-owned surface until the lessee makes provisions to compensate the landowner for all damages sustained by reason of entering upon the land as required by the lease, and, to the extent applicable, the requirements of AS 38.05130, as required in the terms of the lease. The August 27, 1997, Surface Use Agreement ("Surface Use Agreement") between ConocoPhillips and the Kuukpik Village Corporation defined the terms and conditions of ConocoPhillips' use of the surface of Kuukpik's NPR-A lands in exchange for Kuukpik's consent to development of the oil and gas resources on these lands.

Under the Surface Use Agreement, ConocoPhillips held a meeting with the Kuukpik Village Corporation Board of Directors on August 1, 2002, regarding an exploration and land activity update of the Kuukpik-owned lands. In particular, the Kuukpik Board was presented an activity update and plan of operations for each of the proposed Second CRU Expansion areas: Oberon, Titania, Nanuq, and Fiord. The Kuukpik Board members present at the meeting were Leonard Lampe, Sr., Isaac Nukapigak, Sarah Dyagak, Bernice Kaigelak, Archie Ahkiviana, and Emily Wilson. To the Division's knowledge, the Kuukpik Village Corporation has not objected to the proposed Second CRU Expansion.

Also, under 11 AAC 83.311, the DNR is required to publish notice of a unit expansion in a Statewide-circulated newspaper and a newspaper serving the locality in which the unit is located. Further, since the CRU is located within the boundary of an organized borough, regional corporation, and village corporation organized under Section 8(a) of the Alaska Native Claims Settlement Act, the notice was mailed to the North Slope Borough, the President of ASRC, and the President of Kuukpik Village Corporation. In this case, notice was also provided to the Mayor and City Council of Nuiqsut and Barrow, and the radio station, KBRW, in Barrow for broadcast to the North Slope Native community.

With regard to the Native Allotees' surface, the mitigating measures and lessee advisories provide that rights to exploration and development of the oil and gas resources may not be exercised until the lessees make provisions to compensate the landowner for all damages sustained by reason of entering upon the land as required by the lease, and, to the extent applicable, the requirements of AS 38.05130.

In addition to the mitigating measures in the leases, State unitization regulations require the commissioner to approve a Plan of Operations before the unit operator performs any surface operations. 11 AAC 83.346. A proposed Plan of Operations must describe the operating procedures designed to prevent or minimize adverse effects on natural resources. Plans of Operation are subject to extensive technical review by a number of local, State, and federal agencies. They are also subject to consistency with the Alaska Coastal Management Program standards, if the affected lands are within the coastal zone. The unit operator must guarantee full payment for all damage sustained to the surface estate before beginning operations. The Plan of Operations must include plans for rehabilitation of the unit area. Furthermore, when the lessees propose to explore or develop the expansion area and submit a Unit Plan of Operations, the DNR may require that it comply with the lease stipulations and lessee advisories developed for the most recent lease in the CRU, the expanded CRU, or the region.

The approval of the CRU expansion itself has no environmental impact. The unit expansion does not entail any environmental costs in addition to those that may occur when permits to conduct lease-by-lease exploration or development are issued. The commissioner's approval of the unit expansion is an administrative action, which, by itself, does not convey any authority to conduct any operations within the unit. Unitization does not waive or reduce the effectiveness of the mitigating measures that condition the lessee's right to conduct operations on these leases. DNR's approval of the Unit POE and/or POD is only one step in the process of obtaining permission to drill a well or wells or develop the potential and known reservoirs within the unit area. The Unit Operator must still obtain approval of a Plan of Operations from the State, and, if necessary, ASRC, on jointly held leases, and permits from various agencies on State leases before drilling a well or wells or initiating development activities to produce reservoirs within the unit area.

ConocoPhillips plans to drill a number of exploration wells within the proposed CRU expansion area. The proposed surface locations for the wells are on either State of Alaska or Kuukpik Village Corporation conveyed lands. Furthermore, when ConocoPhillips applies for permits and authorizations for the wells from the various federal, State, and local agencies, the allotment owners will have the opportunity to comment during the permit review process.

2. Prior Exploration Activities in the Colville River Unit Area, and Proposed Expansion Area, and the Geological and Engineering Characteristics of the Reservoir.

The CRU and surrounding areas contain multiple sandstone reservoir objectives. Lower Cretaceous Kuparuk 'C' reservoir sandstone potential exists on the down thrown sides of normal faults and in structural lows in the area. Three prospective sandstone sequences are locally present within the Upper Jurassic. In stratigraphic order (from oldest to youngest) they are the Nechelik, the Nuiqsut, and the Alpine intervals. All three of these sequences are oil-bearing. Each interval is a 200-to-300 foot thick coarsening and cleaning upward package composed of sandstone, siltstone, and shale. Each sequence terminates abruptly with a sharp top that is overlain by marine mudstones of the Upper Jurassic Kingak (Nechelik and Nuiqsut intervals) and lower Cretaceous Miluveal formations (Alpine interval). Although all three sandstone sequences are oil-bearing, the older Nechelik and Nuiqsut sandstones have poorer reservoir

properties than the Alpine sandstone; they are slightly finer-grained, more argillaceous, more poorly sorted, and contain heavier API gravity oil.

Around 100 exploration, delineation, and development wells have been drilled in the CRU and Colville Delta areas since 1982. Several wells in the vicinity of the Colville Delta area and the Fiord area (1st Colville River Unit expansion area) have encountered oil-stained Nechelik sandstone. The Sohio Nechelik 1 well, drilled in 1982, was the first well to encounter the Nuiqsut and Nechelik intervals. The Nechelik interval contained porous oil-stained sandstone; the Nuiqsut interval was not of reservoir quality. The upper Alpine sandstone, discovered later to the south in the Bergschrund 1 well, was absent due to truncation and/or non-deposition in the Nechelik well. In the middle 1980s Texaco and Amerada Hess discovered oil-bearing Nuiqsut sandstones to the northeast in the Texaco Colville Delta 1, 1A, 2, and 3 wells and Amerada Hess Colville Delta 25-13-6 well in the Colville Delta area. Although the wells tested oil, the Nuiqsut sandstone had poor permeability. Because of low flow rate tests from these wells, Texaco and Amerada Hess considered the accumulation uneconomic to develop. Due to truncation by LCU and/or non-deposition, the Alpine sandstone is not present in the Fiord Expansion Area. Incomplete sequences of the Nuiqsut interval are present locally but are not prospective as oil reservoirs in the Fiord Expansion Area.

Titania and Oberon Expansion Areas

ConocoPhillips acquired the 3D seismic survey that included the Oberon and Titania Expansion Areas during the 2000/2001-winter season. ConocoPhillips supplied adequate seismic data to justify the areal extent of the Oberon and Titania prospects. All data submitted for the Titania and Oberon Expansion Areas are confidential. Geophysical and geological data submitted and the interpretations supplied by ConocoPhillips justify the proposed Oberon and Titania Expansion Areas.

Nanuq Expansion Area

In April 2000, Phillips and Anadarko announced the discovery of a second CRU satellite, the Nanuq accumulation, located approximately 6 miles south of the Alpine PA. The Nanuq accumulation is estimated to contain more than 40 million barrels of gross recoverable oil reserves. The Nanuq 2 well encountered 50 feet of vertical oil-bearing sandstone in a Cretaceous-age reservoir and nine feet in the Kuparuk reservoir. A combined production test from the Nanuq interval recorded a production rate of 1,750 b/d of 40-degree API gravity oil and 6.5 mmscfgpd from a horizontal completion. The extended reach horizontal well, CD1-229, was drilled from the CRU CD-1 drillsite, and confirmed the extent of the Nanuq accumulation. The well encountered 19 vertical feet of oil-bearing sand in the Nanuq reservoir and initially produced 460 barrels of 41 API gravity oil and 6.5 mmscfgpd from a horizontal interval in the Cretaceous Nanuq reservoir. CD1-229 produced 6,404 barrels of oil and 97,646,000 cubic feet of gas during February 2001. In the following month, it produced 7,036 barrels of oil and 105,742,000 cubic feet of gas. Production was then suspended. Phillips drilled Nanuq 3 and Nanuq 5 in 2001 and 2002, respectively.

Exploration wells that were drilled in support of the Nanuq expansion include: ARCO Nanuk 1 (1996); ARCO Nanuk 2 (2000); Phillips Nanuq 3 (2001); CD1-229 (2001); and Phillips Nanuq 5 (2002). ConocoPhillips acquired the Nanuq 3D seismic survey, covering approximately 80 square miles including a portion of the Nanuq Expansion Area, during the 2000/2001-winter season. All of the data submitted in support of the Nanuq Expansion Area is confidential except for Nanuk 1. Formation tops in Nanuq 1 include: top Albion (-4007' tvdss); top HRZ (-6644' tvdss); LCU (-6942' tvdss); top Jurassic (-7172' tvdss); and top Nuiqsut (-7456' tvdss).

ConocoPhillips provided other confidential supporting evidence in support of the Nanuq expansion area including interpretive well logs for the Nanuk 2, Nanuq 3, Nanuq 5, and CD1-229 wells and geological cross sections and seismic lines, that justify the size of the Nanuq Expansion Area.

Fiord Expansion Area

In 1992, ARCO Alaska, Inc. (ARCO), now ConocoPhillips, encountered oil reservoirs within the Kuparuk 'C' sandstone and Nechelik sandstone in the Fiord 1 well that tested 1,065 barrels of oil per day (BOPD) from 24' of Kuparuk 'C' sandstone and 185 BOPD from 50' of permeable oil-bearing sandstone within the Nechelik sandstone.

ARCO continued its exploration efforts in the vicinity of the ARCO Fiord wells. The Temptation 1/1A wells were drilled west of the Fiord area (and outside the CRU) in 1996. The Temptation 1 and 1A wells encountered 8' of oil-bearing Kuparuk sandstone and about 180' of permeable oil-bearing sandstone in the Nechelik interval. Although the wells were not tested, ARCO continued to explore for commercial quantities of oil within the Kuparuk 'C' sandstone and the three Upper Jurassic sandstone sequences.

Although many wells in the vicinity encountered oil-stained Nechelik sandstone, no accumulations were deemed commercial until ARCO conducted the 1999 Fiord exploration-drilling program in the northeastern part of the Colville River Unit. In early 1999, ARCO drilled the Fiord 4, 5, and 5PB1 wells. On July 6, 1999, ARCO and its partner Anadarko announced the Fiord discovery within the CRU. The announcement stated that the Fiord 5 well contained 60 vertical feet of oil-bearing sand in a Jurassic reservoir and a 15-foot vertical section of oil-bearing sand in the Kuparuk Formation. The Jurassic sand tested at a rate of 1,400 BOPD of 29 degree API gravity oil and 0.65 million standard cubic feet of gas per day (mmscfcpd) after fracture stimulation. A combined test of the Jurassic and Kuparuk sandstones yielded an equivalent rate of 2,500 BOPD of 30 degree API oil and 1.2 mmscfcpd. ARCO estimated that the Fiord accumulation within the current CRU contained more than 50 million barrels of gross recoverable reserves. ConocoPhillips announced plans to develop the Fiord accumulation. Development drilling in the northeastern and eastern side of the Alpine Participating Area (Alpine PA) has demonstrated the presence of thin oil-bearing Kuparuk 'C' sandstone, suggesting that the Kuparuk may be present in the area between the eastern side of the Alpine PA and the Fiord wells.

In support of the first CRU expansion, ConocoPhillips submitted the Temptation 1 well log as the type section of the Kuparuk and Nechelik intervals for the Fiord accumulation. "Nechelik

sand” is the informal name applied to the sequence of reservoir sandstones and associated mudstones within the upper Kingak Formation encountered in the ARCO Temptation 1 well in the interval between 7,330'-7,650' measured depth (md) (-7,296' to -7,616' true vertical depth sub-sea (tvdss)) and its lateral equivalents. The sandstones are fine- to very-fine-grained with porosity ranging between 13-15% and permeability ranging between 1-10 millidarcies. The Kuparuk 'C' sandstone is the formal name applied to the reservoir sandstones in the upper Kuparuk Formation encountered between 7,173' to 7,183' md (-7,140 to -7,150 tvdss) in the ARCO Temptation 1 well, and its lateral equivalents. The sandstone ranges from very fine- to coarse-grained. Porosity ranges between 19-22% and permeability ranges between 40 - 150 millidarcies.

For this Application, ConocoPhillips used the Fiord 5 well as the type log for the Fiord accumulation. Formation tops in the Fiord 5 well include: base HRZ (6735' md); top Kuparuk 'D' (6825' md); Kuparuk 'C' (6863' md); LCU (6878' md); top Nuiqsut (6878' md); and top Nechelik (7006' md). A combined test of both the Jurassic and Kuparuk intervals in the Fiord 5 well produced an equivalent rate of 2,500 BOPD of 30 degree API oil and 1.2 mmscf/gpd.

Several geological factors continue to contribute to exploration risk for success in the area. These factors include the uneven geographic distribution of the Jurassic sediments and the uncertainty of the presence of potential reservoir sand due to erosional truncation and/or non-deposition. The northern truncation of the Nechelik sand by LCU, as is evident in the Fiord 4 well, is difficult to resolve with seismic data. The Kuparuk 'C' sandstones are generally present on the downthrown sides of local faults in the area. Seismic data cannot definitely resolve the presence of Kuparuk 'C' sandstone when it becomes thin (<15 - 20 feet). The Kuparuk 'C' sandstones have locally different porosity and permeability values and contain oils of varying quality.

ConocoPhillips provided the following geologic information in support of the Fiord Expansion Area. The list contains the following exploration wells (followed by the year the well was drilled in parenthesis). Sohio Nechelik 1 (1982); ARCO Fiord 1 (1992); ARCO Temptation 1 (1996); ARCO Temptation 1A (1996); ARCO Fiord 4 (1999); ARCO Fiord 5 (1999); ARCO Fiord 5 PB1 (1999); Phillips Nigliq 1 (2001); and Phillips Nigliq 1A (2001). ConocoPhillips submitted the Fiord West 3D seismic survey, consisting of approximately 70 square miles, acquired during the winter of 1999/2000.

Phillips drilled the Nigliq 1 and Nigliq 1A wells in 2001 to delineate the Fiord accumulation between the Temptation and Fiord wells in the proposed Fiord Expansion Area. The two Nigliq wells are still confidential, but the wells demonstrate that the Fiord accumulation extends into the area between the Temptation and Fiord wells. The northern extent of the accumulation is less certain. The stratigraphic section between the Fiord 5 and 4 wells thins to the north by truncation by LCU. The critical question to answer is the effect of the LCU truncation on potential reservoir rock in the expansion area to the north-northeast of the Temptation and Nigliq wells and the area between the Nigliq and Fiord 5 and 4 wells. Neither well control nor seismic data definitely answers the question.

Alfred James III, an overriding royalty owner in ADL 388527 that lies north of the Nigliq 1A well, submitted written comments, maps, and a log section representing his interpretation of the northern part of the Fiord Expansion Area. Mr. James does not have access to either the confidential Nigliq 1 and 1A wells or the Fiord 3D seismic. His interpretation is based on a published seismic line from OCS Report MMS 91-0076 and USGS line 29-74 and the publicly available well control including the Temptation 1 and 1A, Nechelik 1, and Fiord 4 and 5 wells. James concludes that there is both Kuparuk 'C' sandstone and Nechelik sandstone potential on his lease. His interpretation is that on his lease, the primary target is the Nechelik sandstone that he describes as:

...a thick, pervasive, consistent though low permeability shoreline deposit that seems oil productive everywhere there is reservoir, and is bounded on the north by the progressive truncation by the LCU. The question that will affect the potential productivity of our lease ADL 388527 is where does truncation take place. Secondly, there is potential in Kuparuk C sands in accommodation spaces, syndepositionally in structural lows and contemporary fault blocks and half-grabens. As thin as these sands may be they conceivably are hard to image seismically; there is the probability of thicker packages in rift-related half-grabens basinward.

Mr. James' argument, supported by comments from John J. Darrah, Jr., is technically sound based upon the data available to him. He states that the critical question to answer is the truncation rate of LCU on the Nechelik sequence to the north. Without the 3D seismic survey and the Nigliq 1 and 1A wells, James does not have the information to refine his interpretation. The Division examined the confidential 3D seismic survey and Nigliq wells and has determined that CRU Tracts 112, 113, and 115 should be included in the Fiord Expansion Area. However, the data do not support Mr. James' interpretation and Mr. Darrah's contention that CRU Tract 116 should be included in the Fiord Expansion Area.

3. Plans for Exploration or Development of the Proposed Unit Expansion Area.

ConocoPhillips proposed plans of exploration and/or development for each of the four expansion areas as follows.

Oberon Expansion Area

The Oberon Expansion Area is defined as CRU Tracts 162 through 185 on Attachment 1 and is shown on Attachment 2 and 3 to this Findings and Decision.

As a condition of including the Oberon Expansion Area into the CRU, the WIOs have agreed to the following terms and conditions requested by the Division:

- 1) Drill a test well (1st Oberon Well) by June 1, 2003, to a bottomhole location in the Oberon Expansion Area and to a target interval described in Attachment 3 of the Application. If the 1st Oberon Well is not timely drilled, then the entire Oberon Expansion Area and the entire Titania Expansion Area shall automatically contract from the CRU on June 1, 2003.

- 2) Drill a second test well (2nd Oberon Well) by June 1, 2004, to a bottomhole location within the target interval described in Attachment 3 of the Application that is at least one mile horizontally from the bottomhole location of the 1st Oberon Well. If the 2nd Oberon Well is not timely drilled and located, then the entire Oberon Expansion Area shall automatically contract from the CRU on June 1, 2004, and the WIOs shall make a payment of \$340,000 proportionately to, and as directed by, the Division and ASRC. If the WIOs give written notice to the Division and ASRC by June 1, 2003, that they elect not to drill the 2nd Oberon Well, then the acreage within the Oberon Expansion Area shall automatically contract out of the CRU effective June 1, 2003, and the payment to the Division and ASRC shall not become due.
- 3) The Oberon Expansion Area lands must be included in an approved participating area within 5-years of the effective date of the Second CRU Expansion Findings and Decision. Any Oberon Expansion Area lands not in an approved participating area with 5 years of the effective date shall contract from the CRU on that date. If a participating area is not proposed and approved within 5-years from the effective date of this Findings and Decision, then all of the Oberon Expansion Area shall contract from the CRU.

Titania Expansion Area

The Titania Expansion Area is defined as CRU Tracts 127, 128, and 134 through 161 on Attachment 1 and is shown on Attachment 2 and 3 to this Findings and Decision.

As a condition of including the Titania Expansion Area into the CRU, the WIOs have agreed to the following terms and conditions requested by the Division:

- 1) By June 1, 2003, commit in writing to drill a test well to a bottomhole location within the Titania Expansion Area and to a target interval described in Attachment 3 of the Application. If the well commitment is not timely made, then the entire Titania Expansion Area shall automatically contract from the CRU on June 1, 2003. Drill the test well (1st Titania Well) by June 1, 2004. If the 1st Titania Well is not timely drilled, then the entire Titania Expansion Area shall automatically contracted from the CRU on June 1, 2004, and the WIOs shall make a payment of \$122,000 proportionately to, and as directed by, the Division and ASRC.
- 2) Drill a second test well (2nd Titania Well) by June 1, 2005, to a bottomhole location within the target interval described in Attachment 3 of the Application that is at least one mile horizontally from the bottomhole location of the 1st Titania Well. If the 2nd Titania Well is not timely drilled and located, then the entire Titania Expansion Area shall automatically contract from the CRU on June 1, 2005, and the WIOs shall make a payment of \$244,000 proportionately to, and as directed by, the Division and ASRC. If the WIOs give written notice to the Division and ASRC by June 1, 2004, that they elect not to drill the 2nd Titania Well, then the acreage within the Titania Expansion Area shall

automatically contract out of the CRU effective June 1, 2004, and the payment to the Division and ASRC shall not become due.

- 3) The Titania Expansion Area lands must be included in an approved participating area within 5-years of the effective date of the Second CRU Expansion Findings and Decision. Any Titania Expansion Area lands not in an approved participating area with 5 years of the effective date shall contract from the CRU on that date. If a participating area is not proposed and approved within 5-years from the effective date of this Findings and Decision, then all of the Titania Expansion Area shall contract from the CRU.

Nanuq Expansion Area

The Nanuq Expansion Area is defined as CRU Tracts 118 through 126, and 129 through 133 on Attachment 1 and is shown on Attachment 2 and 3 to this Findings and Decision.

As a condition of including the Nanuq Expansion Area into the CRU, the WIOs have agreed to the following terms and conditions requested by the Division:

- 1) Within 4 years of the effective date of this Findings and Decision, there must be an approved Nanuq Participating Area (Nanuq PA) including CRU Tracts 119, 121-125, 131, and 132. If this Nanuq PA is not approved by that date, then all of the Nanuq Expansion Area shall contract from the CRU on that date.
- 2) The remaining Nanuq Expansion Area lands must be included in an expanded Nanuq PA within 5-years of the effective date of the Second CRU Expansion Findings and Decision. Any Nanuq Expansion Area lands not included in an expanded Nanuq PA within 5 years of the effective date shall contract from the CRU on that date.
- 3) The WIOs shall make a payment of \$16.26 per acre per year proportionately to, and as directed by, the Division and ASRC for each acre of the Nanuq Expansion Area not included in a Nanuq PA within the 5-year period. The payment is for each year after expiration of the lease primary term that the lands are not drilled and producing, and withheld from an area-wide lease sale.

Fiord Expansion Area

The proposed Fiord Expansion Area is defined as CRU Tracts 95 through 117 on Attachment 1 and is shown on Attachment 2 and 3 to this Findings and Decision.

As a condition of including the Fiord Expansion Area into the CRU, the WIOs have agreed to the following terms and conditions requested by the Division:

- 1) CRU Tracts 99, 100, 106, 116, and 117 are deleted from the Fiord Expansion Area.

- 2) Within 4 years of the effective date of this Findings and Decision, there must be an approved Fiord Participating Area (Fiord PA) including CRU Tracts 107, 110-115. If this Fiord PA is not approved by that date, then all of the Fiord Expansion Area shall contract from the CRU on that date.
- 3) The remaining Fiord Expansion Area lands must be included in an expanded Fiord PA within 5-years of the effective date of the Second CRU Expansion Findings and Decision. Any Fiord Expansion Area lands not included in an expanded Fiord PA within 5-years of the effective date shall contract from the CRU on that date.
- 4) The WIOs shall make a payment of \$11.08 per acre per year proportionately to, and as directed by, the Division and ASRC for each acre of the Fiord Expansion Area not included in the Fiord PA within the 5-year period. The payment is for each year after expiration of the lease primary term that the lands are not drilled and producing, and withheld from an area-wide lease sale.

Because only portions of certain Fiord Expansion Area leases, ADLs 388904, 380093, 388527, and 389725, are being committed to the CRU, under 11 AAC 83.373, these commitments constitute severance of the leases as to the unitized and non-unitized portions of the lease. ConocoPhillips requested that the Commissioner grant a 2-year extension of the lease term for that portion of the lease not committed to the CRU. In a September 5, 2002 letter to the Commissioner and the President of ASRC, ConocoPhillips outlined some plans of exploration for the area west of the Fiord Expansion Area. Their request for the 2-year extension was based on these plans. The extension is granted subject to ConocoPhillips completing the proposed activities.

Finally, in the event of the CRU contraction of any of the approved Second CRU Expansion Areas, the WIOs waive the extension provisions of 11 AAC 83.140 and the notice and hearing provisions of 11 AAC 83.374 with respect to such contractions.

The plan of exploration and/or development for the Second CRU Expansion leases with the agreed-to terms and conditions ensures that the lease extensions resulting from unitization under 11 AAC 83.336 continue only so long as the WIOs proceed diligently with exploration and development.

4. The Economic Costs and Benefits to the State and Other Relevant Factors.

Approval of the CRU expansion will provide near-term economic benefits to the State by creating jobs associated with the assessment of the hydrocarbon potential of the leases within the expansion areas. The WIOs have provided sufficient technical data to define the prospects under consideration, have committed their diverse lease interests to the proposed unit expansion areas, and have agreed to a plan of exploration and/or development that ensures a timely sequence of drilling and development activities to evaluate and develop the CRU and the proposed unit expansion areas. The plan of exploration and/or development with the agreed-to terms and

conditions advances exploration and evaluation of the prospects in the expansion areas sooner than would occur under any individual lease exploration effort.

The leases in the CRU and expansion areas are written on a variety of forms, containing a variety of provisions. During the lengthy CRU Agreement negotiations and the discussions for the Application, the parties bargained for amendments to the terms and conditions of the various lease contracts to harmonize them. The WIOs have agreed to a number of lease amendments requested by the Division as a condition of including the four expansion area leases into the CRU. The agreed-to lease amendments are:

1) Paragraph 36(b) of lease form DOG 200204 shall be substituted in lieu of the existing paragraph 35(b) of lease forms DOG 9208AS, DOG 9208AS(Rev.5/93), DOG 9208AS(Rev.5/96), DOG 9208AS(Rev.6/97), and DOG 9607(SSR)AS, and paragraph 36(b) of lease form DOG 200004.

2) All leases subject to a DL-1 lease form and included in the Second CRU Expansion Area will be modified as follows: 1) Delete Paragraph 10 (Minimum Royalty), Paragraph 12 (Discovery Royalty), Paragraph 14 (RIK), Paragraph 15 (RIV), Paragraph 16 (Price); 2) Add the following from lease form DOG 200204: Paragraph 7 (Apportionment of Royalty), Paragraph 10 (POD), Paragraph 12 (Directional Drilling), Paragraph 34 (Definitions), Paragraph 36 (Value), Paragraph 37 (RIV), and Paragraph 38 (RIK).

3) Any ANS Royalty Settlement Agreement will not apply.

Consistent lease provisions allow the WIOs and the State to reduce the administrative burdens of operating and regulating this unit. Conforming the terms of the older leases to the newer form lease and to the unit agreement allows the State to avoid costly and time-consuming re-litigation of the arguably problematic lease provisions in the older forms.

By including the expansion leases under the CRU Agreement, the State will benefit economically from the amendments to the individual leases. Specifically, the discovery royalty provision of the DL-1 lease form was eliminated for the DL-1 leases in the current CRU and in the Oberon Expansion Area. The Alaska Legislature repealed the discovery royalty statute in 1969 and the DNR repealed the discovery royalty regulations in 1979. Although the original discovery royalty statute and regulations were repealed, there are still discovery royalty provisions in the leases issued on the DL-1 form.

Sections 11.6 and 11.8.3 of the CRU Agreement harmonize the various lease provisions that describe the allowable deductions from the State's royalty share. The State's royalty share of production from the Second CRU Expansion leases will be free and clear of all field costs incurred on the North Slope of Alaska. Certain gas processing costs are specifically allowed.

The CRU Agreement has provisions that resolve some of the challenging issues associated with operation of an oil and gas unit. The parties agreed to the methodology for establishing and revising participating areas. The parties have agreed to the basis for allocating production to the individual tracts included in the participating area. The CRU Agreement also describes the

royalty accounting procedures and sets the deemed rate of recovery of certain outside substances injected into reservoirs within the unit. The CRU Agreement makes consistent the dismantlement, restoration, and rehabilitation responsibilities of the WIOs when a unit terminates. The CRU Agreement contains the dispute resolution procedures that the parties have agreed to use if any disputes arise during the operation of this unit.

There are also some potential costs associated with the CRU and the proposed unit expansion. The State agreed to allow the royalty payments for natural gas from the Fiord prospect to be delayed for ten years and for so long thereafter as approved if the Fiord gas is used for repressuring, recycling, storage, or enhanced recovery in another reservoir within the unit.

Also, by extending a number of the Second CRU Expansion leases, the leases continue to be subject to the 1997 Surface Use Agreement between ConocoPhillips and the Kuukpik Village Corporation. The Division requested a copy of the Surface Use Agreement as a condition of its approval of the Second CRU Expansion. The Division does not have a copy of the Surface Use Agreement and was concerned that terms and conditions contained in the document would restrict or prevent exploration and/or development activities within the expanded CRU. As the Surface Use Agreement is a private transaction between ConocoPhillips and the Kuukpik Village Corporation, Kuukpik insisted that ConocoPhillips maintain the confidentiality of the Agreement. ConocoPhillips concurred with Kuukpik. Of the four parties involved with this issue of access to the Surface Use Agreement, the State of Alaska is the only party without the document. A number of meetings were held with ConocoPhillips, Kuukpik and ASRC regarding State access to the Surface Use Agreement. The issue remained unresolved.

As a compromise to resolve this issue, ConocoPhillips stated, in a letter dated October 17, 2002, that the Surface Use Agreement is not be a barrier to meeting the work commitments imposed in this Findings and Decision, and that it will never be used to seek relief from work commitments imposed by this Findings and Decision. Because the Surface Use Agreement governs surface access to a majority of the CRU and expanded CRU, the DNR will accept the ConocoPhillips' statement, but will further require as a condition of its approval of the Application that the Surface Use Agreement will never be a barrier to meeting any work commitments imposed by DNR, and that it will never be used to seek relief from any work commitments imposed by the DNR.

B. Decision Criteria considered under 11 AAC 83.303(a)

1. The Conservation of All Natural Resources.

DNR recognizes unitization of the leases overlying a reservoir as a prudent conservation mechanism. Without unitization, the unregulated development of reservoirs can become a race for possession by competing operators. This race can result in: 1) unnecessarily dense drilling, especially along property lines; 2) rapid dissipation of reservoir pressure; and 3) irregular advance of displaced fluids, all of which contribute to the loss of ultimate recovery or economic waste. The proliferation of surface activity, duplication of production, gathering, and processing facilities, and haste to get oil to the surface also increase the potential for environmental damage (such as spills and other surface impacts). Lessee compliance with conservation orders and field pool rules issued by the AOGCC would mitigate some of these impacts without an agreement to

unitize operations. Still, unitization is the most efficient method for maximizing oil and gas recovery, while minimizing negative impacts on other resources. Including the expansion acreage within the CRU will provide the State with a comprehensive plan for exploring and developing the four expansion areas. Expansion of the CRU and implementation of the plan of exploration and/or development will ensure that WIOs prudently and diligently explore the acreage included in the unit.

The expansion of the CRU will promote the conservation of both surface and subsurface resources through unitized (rather than lease-by-lease) development. Unitization allows the unit operator to explore the area as if it were one lease. Without the CRU Agreement the lessee would be compelled to seek permits to drill wells on each individual lease in order to extend the leases beyond their primary terms. Unitization reduces both the number of facilities required to develop reserves that may be discovered and the aerial extent of land required to accommodate those facilities. Review and approval of exploration and development permits under a unit agreement will also ensure that rational surface-use decisions are made without consideration of individual lease ownership or expense. After unitization, facilities can be designed and located to maximize recovery and to minimize environmental impact, without regard to lease ownership. Although the applicant has not determined the extent of any oil and gas contained in the prospective reservoirs, the Agreement will ensure that the acreage is explored and recovery from the leases is maximized if a commercial hydrocarbon accumulation is discovered.

2. The Prevention of Economic and Physical Waste.

Inclusion of the expansion leases in the CRU will prevent economic and physical waste because the unit operator must have a cost sharing formula, a coordinated exploration and/or development plan, and if a commercial discovery is made, a comprehensive reservoir depletion model. A cost-sharing agreement promotes efficient development of common surface facilities and operating strategies. A cost-sharing agreement and an acceptable unit operator allow the WIOs in the unit to rationally decide well spacing requirements and injection strategies, and construct the appropriate common, joint-use surface facilities. Unitization prevents economic and physical waste by eliminating redundant expenditures for a given level of production, and avoiding loss of ultimate recovery by adopting a unified reservoir management strategy.

Unitized operations improve development of reservoirs beneath leases that may have variable or unknown productivity. Marginally economic reserves, which otherwise would not be produced on a lease-by-lease basis, can be produced through unitized operations in combination with more productive leases. Facility consolidation lowers capital costs and promotes optimal reservoir management for all WIOs. Pressure maintenance and secondary recovery procedures are easier to design and achieve through joint, unitized efforts than would otherwise be possible. In combination, these factors allow less profitable areas of a reservoir to be developed and produced in the interest of all parties, including the State.

The total cost of exploring and developing the Second CRU expansion leases would be higher on a lease-by-lease basis than it would be under unitization terms. Drilling and facilities investment costs will be minimized as a consequence of eliminating a need for numerous sites within the unit area. Locations of individual wells and surface facilities will be selected to optimize

ultimate oil and gas recovery, while minimizing or completely avoiding adverse impacts to the environment.

Reducing costs and environmental impacts through unitized operations will expedite development of any reserves discovered and will promote greater ultimate recovery of any oil and gas from the unit area. This will increase and extend the State's income stream from production taxes and royalties. The revenues to the lessees and unit operator may be reinvested in new exploration and development in the State. Unitization means reduced costs and increased benefits to all interested parties. It benefits the local and State economy, and provides revenues to the State's general, school, constitutional budget reserve, and permanent funds.

3. The Protection of All Parties in Interest, Including the State.

Inclusion of the expansion leases in the CRU Agreement under the proposed plans of exploration and/or development with the agreed-to terms and conditions outlined in Section II.A.3 promotes the State's economic interests because the further exploration and/or development of the prospects within the four expansion areas will likely occur earlier than without unitization. Diligent exploration and development under a single approved unit plan without the complications of competing operators is in the State's best interest. It promotes efficient evaluation of the State's resources, yet minimizes impacts to the region's cultural, biological, and environmental resources. The CRU Agreement also provides for accurate reporting and record keeping, State concurrence with operating procedures, royalty settlement, in kind taking, and emergency storage of oil, all of which will further the State's interest. The modifications to the varying provisions of some of the leases that eliminate discovery royalties and field costs, and provide for reasonable costs of transportation away from the leased or unit area to the point of sale will economically benefit the State. These all protect the State's interest.

Their level of involvement in the unit management process and the dispute resolution procedures protects ASRC's interests. The Kuukpik Village Corporation's interests were protected during the process of negotiating for consent to subsurface development on their lands. They negotiated for specific limitations on surface use of the leases in which they have surface rights. Kuukpik also received overriding royalty interests in the leases as compensation from the working interest owners and ASRC for consenting to oil and gas activities on their lands.

The interests of any Native Allottees within the expanded CRU are protected because the mitigating measures and lessee advisories in the lease provide that rights to exploration and development of the oil and gas resources may not be exercised until the lessees make provisions to compensate the landowner for all damages sustained by reason of entering upon the land. Also, when ConocoPhillips applies for permits and authorizations for the various activities in the agreed-to plan of exploration and/or development from the various federal, State, and local agencies, the allotment owners will have the opportunity to comment during the permit review process.

The State and ASRC will both be able to protect their respective economic interests in the unit management process by the use of the CRU Agreement's dispute resolution procedures, if necessary.

The proposed expansion of the CRU protects the economic interests of all WIOs and royalty owners of a common reservoir. Operating under a unit agreement and unit operating agreement assures each individual working interest owner an allocation of costs and revenues commensurate with the value of their lease(s). The provisions of the CRU Agreement and State law that provide for notice and an opportunity to be heard if they disagree with a unit management decision made by the State or ASRC also protect the WIOs.

III. FINDINGS AND DECISION

A. The Conservation of All Natural Resources.

1. Including all or portions of the forty leases in the CRU will conserve natural resources, including hydrocarbons, gravel, sand, water, wetlands, and other valuable habitat.
2. The unitized development and operation of the leases in this proposed expansion area would reduce the amount of land and fish and wildlife habitat that would otherwise be disrupted by individual lease development. This reduction in environmental impacts and interference with subsistence activity is in the interest of the public and Native Allotees.
3. Before undertaking any specific operations, the unit operator must submit a Plan of Operations to the DNR and other appropriate State and local agencies for review and approval. All agencies must grant the required permits before drilling or development operations may commence. DNR may condition its approval of a unit Plan of Operations and other permits on performance of mitigating measures in addition to those in the leases if necessary or appropriate. Requiring strict adherence to the mitigating measures will minimize adverse impacts on the environment and Native Allotees. However, if the exploration activities in the expansion exploration plan result in the discovery of a commercially producible reservoir, then there will be environmental impacts associated with the reservoir development. All unit development must proceed according to an approved plan of development.

B. The Prevention of Economic and Physical Waste.

1. ConocoPhillips submitted geological and engineering data to DNR in support of the unit expansion application. DNR technical staff determined that the expansion area encompasses all or part of one commercially viable accumulation and one or more potential hydrocarbon accumulations.
2. The plan of exploration and/or development for the expansion areas - subject to the conditions of Section II. A.3 and Section II. A.4 of this

Findings and Decision - meets the requirements of 11 AAC 83.303 and 11 AAC 83.341. The plan is approved for a 5-year period, that is, until November 8, 2007.

3. ConocoPhillips must submit an annual update to the expansion area exploration plan to the Proper Authority for approval. Section 8.1.1 of the CRU Agreement. The annual update must describe the status of projects undertaken and the work completed, and any proposed changes to the plan. Any changes to the unit plan must comply with Article 8 of the CRU Agreement. ConocoPhillips must submit a new exploration or development plan before the expansion area exploration plan expires.
4. For reporting convenience, the annual update to the expansion area exploration plan may be submitted simultaneously with the annual update to the CRU unit plan.
5. Including the expansion leases in the CRU will help assure a fair return to the State from hydrocarbon production from the expanded unit area.
6. The expansion of the CRU will expedite exploration and development of the unit area. The unit expansion provides greater economic benefits to the State than the economic costs to the State of extending the term of the State leases committed to the unit.

C. The Protection of All Parties in Interest, Including the State.

1. The CRU expansion, subject to the conditions of Section II. A.3 and Section II. A.4 of this Findings and Decision, adequately protects the public interest, and is in the State's best interest.
2. The CRU expansion, subject to the conditions of Section II. A.3 and Section II. A.4 of this Findings and Decision, meets the requirements of AS 38.05.180(p) and 11 AAC 83.303.
3. DNR complied with the public notice requirements of 11 AAC 83.311.
4. The unit expansion will not diminish access to public and navigable waters beyond those limitations (if any) imposed by law or already contained in the oil and gas leases covered by this Agreement.
5. The CRU Agreement provides for expansions and contractions of the unit area in the future, as warranted by data obtained by exploration. The Agreement thereby protects the public interest, the rights of the parties, and the correlative rights of adjacent landowners.

6. ConocoPhillips, as Unit Operator, provided evidence of reasonable effort to obtain joinder of proper parties to the CRU Agreement.
7. The applicants for expansion have sufficient interest in the unit to exercise control of unit operations. 11 AAC 83.316(c).
8. The 2-year extension under 11 AAC 83.373(b) of the lease term for that portion of the leases ADLs 388904, 380093, 388527, and 389725 not committed to the CRU is granted subject to ConocoPhillips completing the proposed activities outline in its September 5, 2002 letter.
9. Revised Exhibits A and B to the CRU Agreement shall be submitted to the Proper Authority in accordance with Sections 2.1 and 2.2 of the CRU Agreement.

For the reasons discussed in this Findings and Decision, I hereby approve the Second Expansion of the Colville River Unit. Pursuant to Section 12.1 of the CRU Agreement, this Second Expansion will be effective after the Commissioner and the President of ASRC have signed it.

A person affected by this decision may appeal it, in accordance with 11 AAC 02. Any appeal must be received within 20 calendar days after the date of "issuance" of this decision, as defined in 11 AAC 02.040(c) and (d) and may be mailed or delivered to Pat Pourchot, Commissioner, Department of Natural Resources, 550 W. 7th Avenue, Suite 1400, Anchorage, Alaska 99501; faxed to 1-907-269-8918, or sent by electronic mail to dnr_appeals@dnr.State.ak.us. This decision takes effect immediately. An eligible person must first appeal this decision in accordance with 11 AAC 02 before appealing this decision to Superior Court. A copy of 11 AAC 02 may be obtained from any regional information office of the Department of Natural Resources.

Appeal Code: OGO110802CRUSECONDEXP

Mark D. Myers, Director
Division of Oil and Gas

Date

Attachment 1: Second CRU Expansion Leases/Tracts
Attachment 2: Map of Second CRU Expansion Leases/Tracts
Attachment 3: Map of CRU and Expansion Leases
Attachment 4: Mitigating Measures of Lease Sale 86 and Lease Sale 87

ATTACHMENT 4

Mitigation Measures of Lease Sale 86 and Lease Sale 87

For every lease sale during its best interest finding process, mitigation measures are developed and adopted that reduces, minimize, or completely avoid adverse impacts to area resources and people. Measures are imposed on exploration and development projects to maintain air and water quality, avoid disturbance to wildlife, preserve habitat values, protect subsistence access to resources and historical uses, and protect archaeological sites.

Mitigation measures applied to the CRU were developed after considering stipulations and terms imposed in other oil and gas lease sales; fish and wildlife resource and harvest data; and environmental data relating to air and water quality, solid and liquid waste disposal, and oil spills. Measures were also developed or modified after considering comments submitted by the public, industry, federal and State agencies, and local government. Additional project-specific

mitigation measures will be imposed when the unit operator submits exploration, development or operations plans. State and federal agencies that impose protection measures on drilling and construction projects include ADF&G, ADEC, USF&WS, NMFS, and USACE. For example, a unique set of mitigation measures for the Alpine Development project to the south of the expansion area were developed independently by agencies, environmental groups, industry, and local residents.

Lessees must obtain approval of a detailed plan of operations from the Director before conducting exploratory or development activities (11 AAC 83.158, 11 AAC 83.346). Unit and lease operations must be consistent with the Alaska Coastal Management Plan, and NSB Coastal District Plan. In addition to compliance with these mitigation measures, lessees must comply with all applicable local, State and federal codes, statutes and regulations, and any subsequent amendments. Citizen groups are formed to advise industry on how to avoid impacts to subsistence. For example, the Kuukpik Subsistence Oversight Panel provides guidance and local knowledge to Phillips Alaska Inc. on the Alpine Development Project.

The mitigation measures for the most recent lease sales in the unit, in this case Sale 86 and Sale 87, held on November 18, 1997 and June 24, 1998, respectively, may be applied to all leases in the CRU. For example, measure 12 of Sale 86 and measure 11 of Sale 87 ensures archaeological resources are protected:

Prior to any ground disturbing activity resulting from exploration, development or production activities, the lessee must conduct an inventory of prehistoric, historic and archeological sites within the area affected by activity. The inventory must include consideration of literature provided by the NSB and local residents, documentation of oral history regarding historic and prehistoric uses of such sites, evidence of consultation with the Alaska Heritage Resources Survey and the National Register of Historic Places, and site surveys. The inventory must also include a detailed analysis of the potential effects that might result from the activity.

Measure 15 of Sale 86 and Measure 14 of Sale 87 protects subsistence use:

Exploration, development or production operations shall be conducted in a manner that prevents unreasonable conflicts between lease-related activities and subsistence activities. In enforcing this term the division, during review of plans of operation, will work with other agencies and the public to assure that potential conflicts are identified and avoided to the fullest extent possible. Available options include alternative site selection, requiring directional drilling, seismic and threshold depth restrictions, subsea completion techniques, seasonal drilling restrictions, and the use of other technologies deemed appropriate by the Director. The lessee shall notify the Director of all concerns expressed by subsistence hunters during operations and of steps taken to address such concerns.

Prior to submitting a plan of operations for both onshore and offshore activities which have the potential to disrupt subsistence activities, the lessee shall consult

with the potentially affected subsistence communities and the North Slope Borough (collectively “parties”) to discuss potential conflicts with the siting, timing, and methods of proposed operations and safeguards or mitigating measures which could be implemented by the operator to prevent unreasonable conflicts. The parties shall also discuss the reasonably foreseeable effect on subsistence activities of any other operations in the area that they know will occur during the lessee’s proposed operations. Through this consultation, the lessee shall make reasonable efforts to assure that exploration, development, and production activities are compatible with subsistence hunting, and fishing activities and will not result in unreasonable interference with subsistence harvests.

Measure 17 of Sale 86 and Measure 15 of Sale 87 ensures access to the area will not be infringed:

No restriction of public access to, or use of, the lease area will be permitted as a consequence of oil and gas activities except in the immediate vicinity of drill sites, buildings and other related facilities. Areas of restricted access must be identified and a rationale justifying the area restriction must be included in the plan of operations.

Sale 86 and Sale 87 measures and advisories are clear with respect to concerns of local residents:

The NSB Assembly has adopted a comprehensive plan and land management regulations under Title 29 of the Alaska Statutes (AS 29.40.020-040). The NSB regulations require borough approval for all proposed uses, development and master plans. The NSBCMP policies are included as part of the NSB zoning regulations (19.70.060) and all NSB permit approvals will require the proposal to be substantially consistent with these policies.

Restricting access to and use of fish camps defined in the Nuiqsut Traditional Land Use Inventory may violate NSBCMP and NSBMC subsistence harvest protection and land use regulations. Lessees are advised to consult with the NSB Planning Department and city of Nuiqsut during planning of operations, which may take place onshore.